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ABSTRACT

It is the thesis of this booklet, one of a series intended to apply economic principles to major social and political issues of the day, that minimum wage laws actually hurt those whom such laws are designed to help. From this point of departure, separate subsections examine economic implications of minimum wage laws, including discussion of what determines wages and working conditions, individual hiring decisions, those who are affected by minimum wage laws, results of minimum wage laws, and those who support these laws. Following a discussion of who benefits and who loses, it is argued that when someone without job experience wants a job but is "not worth the going wage rate," the best way to induce firms to hire him or her is to offer to work for a lower wage until enough experience and training has been gained to enable the individual to ask for and receive higher wages in the future. The consequence therefore, of preventing untrained workers from accepting less than the minimum wage, is to prevent them from gaining experience. It is concluded that when wage rates for low skilled labor rise because of a law, firms choose to hire fewer low skilled workers, thus hurting those whom minimum wage laws were designed to protect. (LH)

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Introduction

To analyze the Federal minimum wage, we will look at both the moral issues and the economic issues involved but will pay the most attention to the economic issues. Let's see what the minimum wage really does. Who benefits? Who, if anyone, loses? If you think, "The answer is obvious. The poor benefit. No one loses," you might find the story we are going to tell rather interesting and possibly informative.

In 1938 Congress passed a law requiring employers in many industries to pay workers an hourly wage of at least 25 cents an hour. Firms in industries covered by the law could, of course, pay workers more than 25 cents an hour, but they were not permitted to pay less.

Since 1938, the legal minimum has been increased 15 times to the 1983 rate of $3.35 an hour. During that period the percent of nonsupervisory, nonagricultural jobs covered by the law was extended from 43 percent to 84 percent. The vast majority of industries in the United States are now included in the minimum wage law.

Within the past few years, however, the minimum wage has become a somewhat controversial issue in political and intellectual circles. You might wonder how the concept of a Federally mandated minimum wage could possibly be controversial? How could anyone be opposed to laws saying that employers must pay those on the low end of the wage scale a wage high enough to guarantee them a "decent standard of living?" But there are people who are opposed. And these opponents are not necessarily cold hearted, callous enemies of the poor. In fact, many people who would like to see the minimum wage abolished, or possibly reduced, argue that such laws actually hurt the poor — the very people the minimum wage is supposedly designed to help.

But people who support a minimum wage might answer, "What's wrong with requiring firms to pay their workers at least $3.35 an hour for their work? That's not much by today's standards."

Some would argue that if it were not for the legislated minimum wage, many people would be exploited by unscrupulous employers who would not pay them a decent wage. Wouldn't workers at the low end of the pay scale be forced to work under terrible working conditions? We would be back to the sweatshops of the 19th century. And what about blacks, Hispanics or females? Wouldn't they be forced to work for exploitive wages because of race or sex discrimination? If minimum wage laws didn't force employers to pay workers at least $3.35 an hour, wouldn't those on the bottom of the wage scale be worse off than they already are?

Who could object? Well, this simple method of reasoning is nice. The problem is, it's wrong. As is the case in most economic questions —

and this is an economic question — the problem is that the solution is not as simple as it seems.

All of these moral issues are important, but to understand the real effects of a minimum wage, we must understand the economic implications involved. So before we return to these moral questions, let's look at the economics of the issue.

To see why people of good will differ in their opinion about the effects of minimum wage laws, let's take an in-depth look at these laws. Let's see what minimum wage laws actually do. What are the issues? Whom do they hurt and whom do they benefit? After we examine these questions, you can make up your own mind.

What Determines Wages and Working Conditions

Employers (or firms) employ workers because labor is generally an important resource used in the production of goods and services. The goods and services are then sold for a price in the market. The revenue or income of the firm is the amount taken in from these sales. The firm, of course, has to pay a cost — the amount that must be paid to the resources used to produce the goods and services that are sold.

If its revenues are greater than its costs, the firm makes a profit. But, if costs are greater than revenues, a loss is suffered. Of course if the firm suffers losses for very long, it will go out of business — a situation that few, if any, managers find particularly desirable. So presumably managers of firms set their production and marketing strategies with the goal of making profits. If they don't, they won't be managers for very long. And, the greater the profits, the more successful the firm; and the more successful the firm, the higher are the incomes of the owners and managers. Thus managers and owners want to make as much profit as possible. So we start with the assumption that managers try to maximize profit, at least in the long run.

So you might ask, if owners want to make more profit, why don't they simply increase the prices of the products they sell or decrease the amounts they pay to sellers of machinery, to workers, or to sellers of other inputs used in the production process? The answer is simple. Competition.

If McDonald's raises the price of its hamburgers fifty cents, it loses sales to Burger King or Wendy's. If Ford increases the price of its cars by $500, GM, Toyota and Volkswagon gain sales. Ford sells fewer cars. We could go on and on. The fact is, there is a limit to the amount a firm can charge based on the availability of competitive products. An increase in price may well lead to a decrease rather than an increase in profit.

So if they can't raise prices arbitrarily, why not reduce costs? Again, competition. Say the law firm of Smith, Jones and Miller tries to reduce its costs by reducing the wages it pays its secretaries from the "going wage rate" of $6.00 an hour to $4.00 an hour. If you were a secretary for

Smith, Jones and Miller, what would you do? Probably leave and go to work for another firm for $6.00 an hour. So Smith, Jones and Miller must — if they wish to hire and keep secretaries — raise their wages back to $6.00.

The same thing is true in other occupations. If Sears cannot hire as many clerks as it desires at $5.00, it is paying too low (below market) wages. Hence it must raise wages if it wishes to hire more clerks. Of course, the reverse is true. When more people want to work in a particular occupation than employers want to hire at the given wage level, there is an overabundance of workers in that occupation. As you would expect, an oversupply of people wanting to work in an occupation at a given wage rate causes wages in that occupation to fall.

So let's stop for a moment and summarize. If more people want to work in some occupation — secretary, lawyer, janitor, teacher — than employers want to hire, salaries fall in that job. If employers want to hire more people for a particular job than there are people willing to work at the job, salaries rise.

Just as competition among firms limits the amount firms can charge for their products, competition among firms for workers and among workers for jobs determines wage rates in different occupations. Certainly while workers compete with other workers for jobs, firms must compete with other firms for the available workers. The competition of workers for jobs has the effect of forcing wages down. But just as important, or perhaps more important, the competition of firms for workers drives wages up.

To see how the market for labor works, we will complicate the discussion a bit to show how this type of competition works. Let us formalize the question of how wages and the number of workers in an occupation are determined. To do this we shall set up a simple economic model of supply and demand in labor markets. This framework of analysis can help us examine the actual results of minimum wage legislation, so that we can compare these results with the intended goals of the policy makers.

First we turn to the demand for labor by firms. Let's take a hypothetical case of dockworkers in a major seaport -- New York, Houston, or New Orleans. Many firms in the area are in the business of loading and unloading ships. To carry out this task these firms hire and use loading machinery (such as cranes), office staffs (secretaries, clerks), and laborers.

Firms can load and unload ships in several different ways. Obviously, they can load and unload ships using practically nothing but manual labor. Men can carry the freight from the ships' holds to the dock then to the warehouse by hand. They can carry the crates on their backs or possibly use simple tools such as rope and two-wheel hand trucks. This method requires a lot of labor but not much mechanical equipment. We

know this is a possibility, because we can observe it being used in seaports in underdeveloped countries where labor is very cheap.

In contrast, firms can use a lot of advanced capital equipment, such as cranes and forklifts, and a few skilled workers. They can use computers to keep track of the freight at every step of the operation. This method requires almost no pure physical labor. We know this is also a possible solution, because we see it being used in areas where labor is quite expensive.

Or, firms can choose among many possible combinations between the two extremes. That is, some pure physical labor can be used along with some capital equipment. We see examples of these combinations also.

So why would firms in one area choose one pattern of loading and unloading ships, while firms in other regions use another? The answer is obvious. Where wages are low relative to the price of capital equipment, firms use a lot of labor and very little capital. Where wages are relatively high, we would expect less labor and more capital equipment to be used. We would expect firms to hire more workers at low wages than at high. When wages are high we would predict that firms would substitute machinery for labor when they can.

If wage rates on the docks increase, firms would decrease the number of workers hired. Or the high wages could force some firms out of business, causing less labor to be used on the docks. If labor became cheap, firms would use more labor, substituting workers for machinery. To summarize, the lower the wage rate for dockworkers, the more dockworkers firms want to hire.

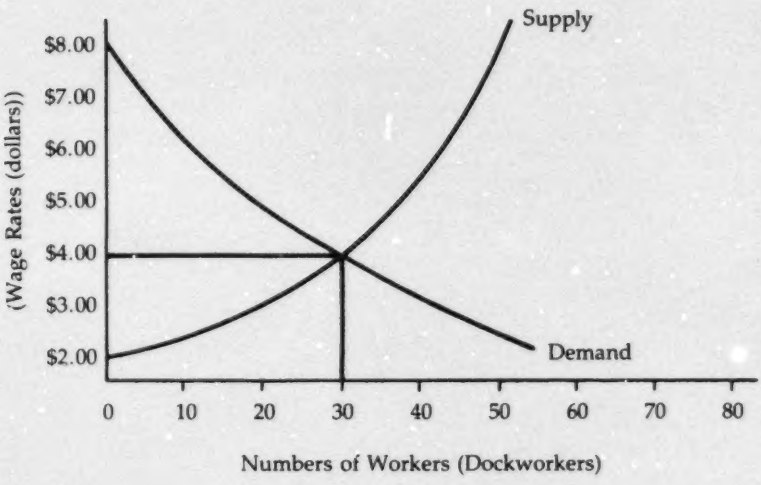
This situation is shown graphically in Figure 1. Wage rates are plotted along the vertical axis; number of workers are along the horizontal. We will simplify for now and assume all workers are alike. The line labeled "Demand" shows the number of dockworkers that would be hired at each wage rate. In this example, no workers would be hired at a wage above $8.00 an hour. The demand curve slopes downward to reflect the fact that firms would wish to hire more workers at lower wages than at higher.

Now let's talk about the supply of dockworkers. How can firms obtain more workers on the docks? The answer is simple. Pay higher wages. Loading and unloading ships is hard work. To induce people to work on the docks, firms must bid them away from other occupations. Possibly other occupations where the work isn't quite so hard. So the higher the wages on the docks, the greater the number of workers who want to be dockworkers.

In Figure 1 this situation is shown by the line labeled "Supply". The "supply curve" shows the number of workers who are willing and able to be dockworkers at each wage rate. The positive slope of the curve reflects our argument that a greater number of workers will be available

at high wages than at low. If firms want to hire more workers than are willing to work at a particular wage, they must pay more. Note that in our example no workers would wish to work on the docks at any wage below $2.00.

Figure 1



So what will be the wage rate and the number of workers hired in this hypothetical situation? Well, we can see that the market is cleared at a wage of $4.00 an hour. This means that at this wage rate, firms want to hire exactly the number of workers who want to work at this wage (30,000). We call this situation "equilibrium". Equilibrium occurs at the wage at which the number of workers who want to work equals the number of workers employers wish to hire.

To show that equilibrium will occur at a wage of $4.00 with 30,000 workers employed, assume that some other wage exists. Suppose the wage is $3.00 an hour. At this wage only about 20,000 workers are available, as shown by the supply curve. But at $3.00, firms want to hire approximately 40,000 workers, as shown by the demand curve. So we have firms wanting to hire 20,000 more dockworkers than are available at $3.00 an hour.

This situation simply can't go on very long. Firms want more labor. How can they get more? Obviously by paying higher wages to bring in more workers. So they begin bidding for labor. Wages must rise to $4.00. At any lower wage, firms face a "shortage" of labor. They want to hire more workers than are available at that wage rate. Any time we see a shortage of labor in a market, we know wages are "too low" — that is, they are below equilibrium. And in such cases, wages will be bid up. So we have eliminated any wage below $4.00 as unstable.

Now turn to the case of a wage rate of $5.00 an hour. At $5.00 we have a "surplus" of labor. The demand curve indicates that firms will hire only about 20,000 workers at $5.00. On the other hand, from the supply curve, we can see that approximately 40,000 workers want to work on the docks at this wage. We have a "surplus" or excess supply of around 20,000 workers. Wages must fall. At any wage above $4.00, more workers wish to work than there are available jobs at that wage. Firms see more job applicants than there are jobs and therefore know that they can decrease wages and increase profits. And they do so.

So we see that the wage rate and the number of workers hired are set at the equilibrium where supply equals demand. At any wage above equilibrium, a surplus of labor exists and wages must fall. At any wage below equilibrium, there is a shortage of labor and wages are bid up.

We might ask, if the equilibrium wage is $4.00 an hour, what might cause the wage to increase on the docks? There are two possible causes. One possibility is a decrease in the supply of workers on the docks. Suppose job opportunities for labor improve in other sectors of the economy — for example, in construction. Some workers leave the docks to take jobs in these other businesses. The number of workers available at each wage rate for work on the docks decreases. This decrease in the supply of workers causes a shortage of labor at the old wage of $4.00. As we have seen, when a shortage develops, wages are bid up.

Another cause of wage increase is an increase in the demand for dockworkers. Suppose a huge unexpected grain sale to Russia takes place. Firms in the loading industry are faced with a large increase in the number of ships they must load. What does this do? Loading more ships requires more labor. So we would expect the demand for dockworkers to increase. Firms now want to hire more workers at each wage than they wanted to hire before the grain deal. This increase in demand leads to a shortage of workers at $4.00 an hour. Firms want to hire more workers than are available at this wage rate. Again, wages must rise as firms bid for workers.

So we can see from this simple example what determines wages and the number of workers hired in different industries. Clearly supply and demand. We can also see what causes wage rates and the quantity of labor to change. Changes in the demand for and supply of labor.

You might think that this example oversimplifies conditions in the real world. And it does. Certainly it does not consider the many real-world complications. Workers differ in their skills and work habits. Firms in the same industry differ also. But actual wages are determined by supply and demand. When wages are too high, some workers are unemployed in the industry. When wages are too low, firms want to hire more workers than are available at those wage rates. In both cases, wages must and will change — that is, they will change in the absence of a law saying they can't change.

Now let us turn to an analysis of what determines working conditions, what protects workers from employers who would subject them to an inhumane work environment? Why won't unscrupulous employers, in an effort to lower costs and make more profit, force workers to work in dangerous or obnoxious areas? The answer is high wages.

Let us again consider a hypothetical example. Suppose we have two large construction firms, each of which hires workers — welders, riveters, crane operators, and so forth. One firm builds one-and two-story apartments. The other puts up 70-story buildings. Clearly, working more than 20 stories above the ground is much more dangerous than working on the ground.

Who must pay the higher wage rate for workers with equal skill? Obviously, the high iron workers will demand and obtain higher wages to compensate them for the extra risk. If the builder of skyscrapers didn't pay higher wages, he would have a very difficult time luring workers away from jobs with less dangerous working conditions. Those who are less risk averse (who don't mind risk as much) will willingly accept the increased danger in return for the higher income. Workers who are more risk averse will be willing to sacrifice increased income for more safety.

The same thing holds true in other occupations. Suppose one or more firms in an industry substantially improve the working conditions for their workers. They may have cleaner work areas, less noise and air pollution, or higher safety standards. As word gets around, more workers will want to work for the firms with better conditions. So these firms will find that they have a greater supply of labor from which to choose. Clearly, the firms with the better working environment will be able to pay lower wages than the other firms, because more workers want to work for them.

The reverse would happen to firms that, in an effort to reduce costs, let the work environment deteriorate relative to that of other firms. These firms, faced with a decreased supply of labor because of poor working conditions, would have to pay a premium wage to attract workers. Some workers would, of course, be willing to accept the poor environment, if they were compensated with higher incomes. Some

would also want to work under better conditions, even if it means lower income.

So you can see that the market determines working conditions in the same way it determines wages. The poorer the working conditions relative to those of other firms, the lower is the supply of labor available to the firms and the higher the wages that the firm will have to pay. In this way, relative wage rates and the preference patterns of workers between income and working conditions set what working condition will be.

Individual Hiring Decisions

We have seen how basic wage rates are determined in individual markets. But before we turn to the effects of legislated minimum wages, let's examine individual hiring decisions and discuss some implications of our analysis.

Going back to our previous example of dockworkers, we can talk about some possibly more realistic individual cases. Suppose you want to work on the docks and apply for a job. You go to the manager of one of the firms and say you want a job. The manager has a few jobs open at the time and so looks at your resume. Will you be hired? If the manager is convinced that you can add more than $4.00 an hour — the going wage rate — you get the job. You are "worth" $4.00. You say, "I want more than $4.00 an hour." He answers, "Look, they're a lot of guys out there I can hire at $4.00. Sorry, $4.00 or no job." So you take the job, or you look somewhere else.

But suppose, after examining your resume, the manager says, "I know you need the job, but because of your lack of experience, you just won't add $4.00 an hour to my revenue. Sorry." He thinks you aren't worth $4.00 an hour.

How can you get the firm to hire you. Well, you're smart. You say, "Look, I know I don't have the experience, but I can learn. Pay me $2.50 an hour. I'm worth that. I can add more than $2.50 to your revenue. As I gain experience, I'll be worth more, and, when I get experience, my wage will go up."

The manager believes that you are indeed worth at least $2.50. If, when you get experience, your wage doesn't rise to $4.00 or more, you can leave and work for another firm. But, in the meantime, at $2.50 an hour you are contributing to the firm's profits. Anyway, when you are worth more, it will be worthwhile for the firm to pay you more in order to keep you.

Do you get the job? Probably. That is, if there are no laws or restrictions on the firm's paying you less than $4.00.

So what have we seen from this example? Hiring decisions are made on the basis of whether or not the prospective employee will add more or less to the firm's revenue than the wage paid to the worker.

Firms must hire on this basis. If they don't, they go broke. And bankrupt firms do not hire workers.

This analysis doesn't just apply to unskilled workers. New lawyers must accept less from law firms than experienced lawyers are paid. They are worth less (not worthless), because they will add less to the revenues of the law firms than the experienced lawyers. The same applies to inexperienced engineers, plumbers, and steelworkers. The way to obtain experience and training is to work for less than the wages paid to experienced or trained workers, no matter what the occupation.

If someone is out of work and wants to get a job, how can firms be induced to hire more workers. The worker can accept less. We have seen that the lower the wage rate, the more workers the firm wants to hire. So how can people with little or no experience get on-the-job training? Work for lower wages, if they are allowed to.

Finally, let's say something about discrimination in hiring. Much as we might deplore it, many employers prefer to hire workers of a particular race or sex. Like it or not, this is outright discrimination. Given a choice, many employers would prefer to hire male workers rather than female; or white workers rather than black or Hispanic. So how can a female, or a black or an Hispanic overcome their "disadvantage"? How can these people compete with more favored workers?

The only answer is, accept lower wages. If an employer wants to discriminate by sex, he would choose males rather than females at a given wage rate of say $7 an hour when both are available. But if females would be willing to do the same job at $5.00 an hour, and they are just as capable, the employer might very well reconsider. Now discrimination costs him money — $2 an hour, $16 a day. And add this amount over several employees. Hiring males rather than females now costs the firm profits. When discrimination is costless — that is, when all workers must be paid the same wage — we would expect to see more discriminatory hiring policies. When discriminatory hiring costs the firm money, we would expect that such policies would be reduced. The more costly is discrimination, in the form of reduced profits, the less discrimination will be practiced.

But, you say, "Isn't the very act of paying females or black workers less than the wages paid to white males discrimination in itself?" And your question is well taken. Of course you are right. But we can't simply change people's prejudices. Their behavior, however, can be changed by making it costly to put these prejudices into practice.

In any case, would you prefer that people of a certain race or sex be permitted to accept lower pay, but be able to obtain jobs? Or would you rather prohibit firms from paying these workers lower wages and prevent them from working? Sometimes the only alternatives are unemployment or lower pay. Not the best alternatives perhaps but the only ones that are relevant.

But there is a possible bright side of the question. As firms hire blacks, females and so forth at lower wages, these firms become more profitable, if these workers are, in fact, as productive as more favored workers. These firms will be able to undersell those firms that don't hire these less costly workers. Because of competition, others will be induced to hire minority workers in order to increase profits. This increase in demand will cause the wages of the disadvantaged workers to increase. As more and more firms try to hire blacks, females, and so forth, these wages must be bid up, perhaps not to the same amount as those of more favored workers, but higher than would otherwise be the case.

This is the way the market works. In any case, we shall return to this important question of hiring discrimination after we have examined some implications of minimum wage legislation.

The Minimum Wage — Who Is Affected?

Until now we have discussed the determinants of wage rates and hiring decisions within a non-regulated framework. Wage rates are determined and hiring decisions are made within the framework of freely functioning markets. But let's change all of that and impose a minimum wage and see what happens.

At this (publication) time, the Federal minimum wage is $3.35 an hour. Firms in almost all industries must pay employees at least $3.35 an hour. They can pay more, of course, but they are not permitted to pay less.

Obviously those who established this minimum believe that no one should be forced to work at any wage below $3.35. The argument is that people would not be able to enjoy a decent standard of living at any lower wage, so they must be better off with a legislated minimum wage.

But let's take the argument a step further. If people are better off with a minimum wage of $3.35, why not make them even better off and set a minimum of $5? Or better yet, $10; or even $20 an hour? Why not $50 an hour? But you say, "That's silly; a minimum wage of $50, or even $20, would put a lot of people out of work." We would ask why?

You answer, "Well, some people just aren't worth $50 an hour or even $20. These people would be thrown out of work. They couldn't get a job. Some firms just can't pay $50 an hour, or even $20. They would have to go out of business. And firms that go out of business don't hire workers. So this high a minimum wage simply isn't logical."

We would agree. These levels would cause a great deal of unemployment. They would hurt the very people they were designed to help. So these levels of wages are silly. They would truly cause massive unemployment. So a $50 or a $20 minimum wage simply isn't politically acceptable.

But isn't it a matter of degree? Many people are not worth $50 an hour or even $20, but some people aren't even worth $3.35 an hour. Or,

they are not perceived by firms as being able to add at least this amount to firms' revenues. This is sad but true. You can force firms to pay at least $3.35 an hour to the workers they employ, but you can't force them to hire everyone who applies for work at this wage. Particularly people whom they perceive to be worth less — those who would add less to their revenues.

So what happens? The same thing that would happen at a $20 minimum wage, but to a lesser extent. We get unemployment among those with lower skill levels. Those worth less than $3.35 won't be hired. People without job skills are unable to find low paying jobs where they can get on-the-job training. Firms are not allowed to pay low wages while training these unskilled workers.

As we discussed in our above examples, when someone without job experience wants a job but is not worth the going wage rate, the best way to induce firms to hire him or her is to offer to work for a lower wage. In this way workers can get the experience and training that will allow them to ask for and receive higher wages in the future. But when untrained workers are forbidden by law from accepting less than $3.35, they are prevented from getting this experience. They are consequently relegated to the unemployment roles. Instead of becoming productive workers, they become unemployment statistics — statistics that everyone complains about.

As we discussed, when wages are increased, for whatever reason, firms hire fewer workers. When the wage rate for low skilled labor rises because of a law, firms choose to hire less low skilled labor. They are induced to find substitutes for low skilled workers. They can substitute machinery for unskilled workers, as we discussed above; but, firms can also substitute skilled labor for unskilled. Let's look at a hypothetical example to illustrate how this latter type of substitution takes place.

Suppose you want to build a patio in your yard. There are two choices. You can hire a skilled carpenter, who can build the patio in one day, at $20 an hour. Or you can hire an unskilled laborer at $5 an hour. But it takes this worker three days to build the patio.

What would you do? Probably choose the method that costs less. The cost of the carpenter is $20 times eight hours, or $160. The cost of the unskilled worker, who can presumably build just as good a patio, is $5 times 24 hours, or $120. If the extra two days do not matter too much to you, you choose the cheaper method and hire the lower skilled worker, saving yourself $40.

But if the price of the unskilled worker is $8 an hour, the total cost of building the patio in this way is $192. Just because the wage is arbitrarily set at $8, doesn't mean the unskilled worker suddenly becomes more productive in the sense of being able to build the patio more quickly. It still will take him three days or 24 hours to build the patio. So now it is cheaper to use the skilled worker and pay the higher wage rate.

Exactly the same type of analysis applies to the substitution of machinery for unskilled labor. We saw in our example of loading and unloading ships that cranes could be substituted for unskilled labor if wages became too high. The same thing can occur in many, many other industries. Mechanical sprayers can replace painters using a brush. Self service can replace sales clerks in retail stores. Push-button elevators have replaced operators, at least in privately owned buildings. The only elevator operators we have seen recently are in Federal office buildings. Of course, the Federal government doesn't have to make a profit or live within a budget. And you can surely think of many other examples of such substitution.

So what conclusions can we draw from our analysis? Well, the first conclusion is that those potential workers, whose low skill or lack of experience causes them to be worth less than the minimum wage, will not be employed in sectors of the economy covered by minimum wage laws. The sectors covered include 84 percent of all jobs in the non-agricultural sector of the economy. So many people who can't find jobs in the covered sectors try to obtain jobs in the relatively small, non-covered sectors, consequently driving down wages even further in these areas. Some potential workers simply remain unemployed or completely drop out of the labor force, knowing they will not be hired. So we would predict that one effect of a minimum wage will be unemployment among those with lower skills.

Let's analyze the situation graphically using, once again, demand and supply curves. In Figure 2, wage rates are plotted along the vertical axis and the quantity of labor along the horizontal. The two labeled curves represent the demand for and supply of unskilled labor in a particular sector of the economy covered by minimum wage legislation. The demand curve shows the number of workers who would be hired at each wage rate by firms in this sector of the economy. The supply curve shows the number of workers willing and able to work at each wage in this sector. As before, the demand curve slopes downward and the supply curve upward, reflecting our previous assumptions.

In Figure 2 we see that in a freely functioning market, the equilibrium wage would be $3.00 an hour. The amount of labor that would be hired at this wage is L. The market is in equilibrium at this wage, because, at $3.00, everyone who wants to work at this wage finds a job. At any wage above $3.00, a surplus of labor exists. More people want to work than firms are willing to hire. At wages lower than $3.00, firms want to hire more workers than the number willing to work. A shortage occurs.

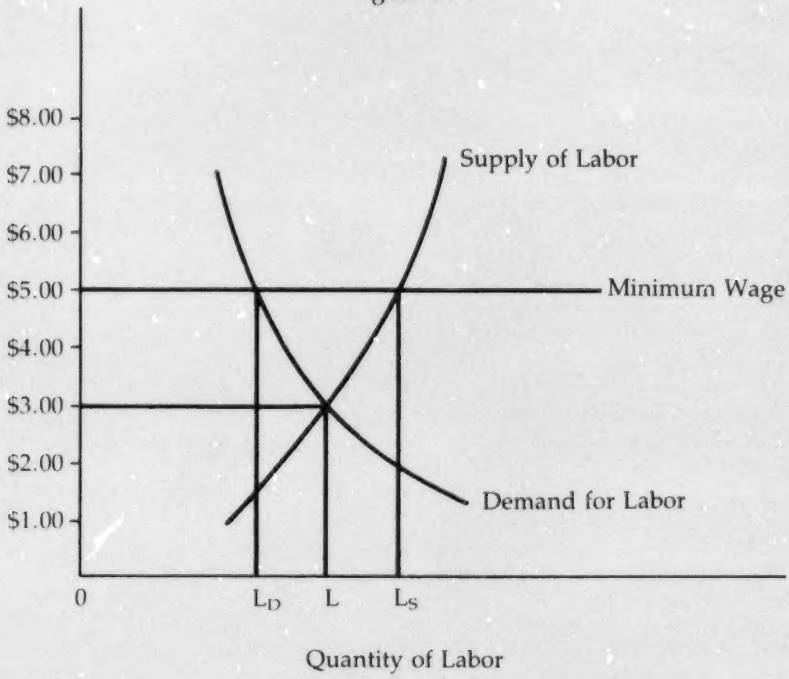
Now let a hypothetical minimum wage of $5.00 be imposed. Firms can pay no lower wage. At $5.00 firms want to hire fewer workers than they did at $3.00. The number of workers hired is L_D — the quantity of

labor demanded. But, at \$5.00, L_S workers want to work. This is the quantity of labor supplied.

It is easily seen that a surplus of labor results. Fewer workers are hired but more want to work. The surplus is shown as the distance L_DL_S, the difference between the amount of labor supplied and the amount demanded at \$5.00.

As we saw before, when wages are above equilibrium, competition will drive them down until everyone who wants to work finds a job. But now wages are not permitted to fall below \$5.00. So L_DL_S workers remain unemployed after the minimum wage is imposed. These workers are made worse off by the law. And these workers are people with the least skills and experience.

Figure 2



Let's look at who these low skilled inexperienced workers really are. One such group would be young people, particularly teenagers. Since teenagers have not had the chance to gain job experience, they are, on the average, less skilled than older workers. And, as we have seen, the mere existence of a minimum wage prevents young people from working at lower wages in order to get on-the-job training. So we would expect high unemployment among the young.

We would also expect more discrimination by race and sex. A minimum wage causes such types of discrimination to be cheaper. Firms that would be willing to hire black, female or Hispanic workers at lower wages and therefore undersell firms that do not, are prohibited from doing so. Firms that do want to discriminate find that there are more people willing to work at the minimum wage than there are jobs. So they are able to discriminate at no cost. These groups that may be discriminated against have no way of showing that they are as productive as more favored workers by accepting lower wages while they show what they can do. So we would expect more race and sex discrimination to occur under a minimum wage than would be the case otherwise.

The same holds true for potential workers with a physical or mental handicap. Many times, such handicapped workers have shown that if given a chance, they can do just as good a job as workers who are not handicapped. But they must have the chance. And sometimes the only way they can get the chance is to accept jobs at lower wages. If these lower wages are below the minimum, they never get the opportunity and are therefore, relegated to the unemployment roles.

Now let us pause to summarize our conclusions. What have we seen? First, we have seen that any minimum wage imposed above the wage that would prevail in the absence of regulation, causes some unemployment in the sectors that are covered. More people want to work at that wage than firms are willing to hire. The extent of the resulting unemployment depends upon the level of the imposed wage and the extent of the coverage. The higher the minimum wage and the greater the coverage, the higher will be the level of resulting unemployment.

Second, we have deduced that the least productive workers will be the hardest hit by the resulting unemployment. Those who have the least experience will be unable to accept jobs at lower wage rates in order to gain the skills necessary to make them productive, self-supporting members of society.

Third, we would predict that black, female, Hispanic, and handicapped workers would find it more difficult to find jobs. The minimum wage makes discrimination less costly for firms that wish to discriminate. Again, less favored workers cannot accept lower wages while they prove themselves to employers.

Some Evidence

So now that we have our predictions, let's look at some evidence to see what has actually happened. From 1962 to 1983 the minimum wage was increased from $1.15 an hour to $3.35. This is a greater percentage increase than the rate of inflation over the same period. So the minimum wage, net of inflation, rose. During the same period the percent of all non-agricultural jobs covered by minimum wage legislation was increased from 62 percent to 84 percent. So the number of jobs available for those who cannot find jobs in the covered sectors of the economy was signicantly decreased relative to the total number of jobs. Finally, the minimum wage as a percent of average wages in manufacturing has remained relatively constant at approximately 50 percent.

We have argued that increases in the minimum wage and in its coverage would affect minority and teenage unemployment most severely. And that is exactly what we have seen. In 1954, 85 percent of white men over the age of 20 were employed. At that time, 80 percent of black men over 20 were also employed. In 1982, during a period of recession, less than 66 percent of black men had jobs, compared with about 75 percent of white males. The unemployment rate for black, teenage males was about 50 percent at the time. That is, one-half of all black, teenage males in the labor force could not find a job. In some cities the figure was around 70 percent. And, since this figure does not include those who became discouraged and stopped looking for work, it probably underestimates the actual unemployment for this group.

That is, the unemployment statistics count as unemployed only those people who are unemployed and actively searching for a job. Thus people who are out of work but are not seeking a job are not counted as unemployed. Potential workers who realize that, for some reason or another, they will not be able to find a job are not unemployed — at least according to the statistics. This would probably include many teenagers, particularly minority teenagers.

There is additional evidence that the minimum wage hurts minority teenagers. In 1961, 45 percent of all white males between the ages of 16 and 20 had jobs; 45 percent of all black males in this age group had jobs also. By 1979 — prior to the recession — 55 percent of the white males between 16 and 20 were employed, an increase of 10 percent. But, over the same period the percent of black males 16 through 19 who were employed fell to 29 percent, a decline of 16 percent.

Surely, no one would argue that black teenage males had significantly greater job skills, relative to white teenagers, twenty years before. Certainly black teenagers were not better educated at that time than they were in 1979. The same thing must hold for males over 21. The only answer seems to be that there are relatively fewer jobs available for black males, particularly black teenagers, now than before. Why? Well one important reason for the substantial decrease in employment of black,

teenaged males could well be the big increase in the coverage and the level of the minimum wage. As we have argued, the higher the minimum wage and the fewer the number of jobs in the uncovered sectors, the poorer the chance of workers with lower skills of getting jobs and the easier it is for employers to practice job discrimination. Thus, as is frequently the case, a law designed to help a particular group of people actually ends up hurting that same group.

But you might ask the question: "Aren't those low skilled workers who are prevented from obtaining jobs by a minimum wage supported by welfare? Doesn't the government take care of them?"

We would answer, "Yes, to some extent. But 'No' in quite a few cases. Many are literally thrown out on the street".

But, we would argue that the very nature of a minimum wage keeps those with low skills from acquiring the training to enable them to become productive members of society in the future. Welfare doesn't do this, even in cases where it is forthcoming. All welfare would do in these cases is to encourage a way of life that is passed on from generation to generation. This can't be good for the individuals involved or for society in general.

And, in a huge number of cases, welfare is not available. All too frequently, the alternative to non-existent jobs is crime. We have witnessed a massive increase in the crime rate for inner city youths over the past couple of decades. In many areas, crime has become a way of life. Certainly we would think that productive job opportunities and training would have been a more than satisfactory alternative for many of the young who have turned to crime.

So society as a whole has had to pay the cost. These costs take the form of the criminal activities themselves, the necessary additional police and protection costs, the costs of prisons, courts and so on. Thus one additional effect of minimum wage increases may well be the added costs of criminal activities.

To summarize, anytime the minimum wage or its coverage is increased, more people are available for work than there are jobs available at this wage. Hence employers, seeing lines of available workers can require workers to have even higher skills than they would require at lower wages. They can also set standards, at least implicitly, that discriminate against certain disadvantaged groups of potential workers. And finally, with higher wage rates and many available workers, firms can let their working conditions deteriorate in order to cut costs. They can hire all the workers they want at the minimum wage; so why improve working conditions?

Who Wants a Federally-Legislated Minimum Wage?

We have thus far probably given the impression that those who support and press for minimum wage laws do so because they want to

benefit workers at the low end of the wage scale and give them the possibility of a better standard of living. While they may not recognize the consequences, their motives are charitable.

Many supporters may indeed fit this description, but many others do not. Many of the strongest supporters recognize full well the effect on unemployment. Surely though, you might ask why. To see the answer, let's look at who benefits from such laws. We have examined rather closely the reason some people are hurt, but we have not yet examined why some people are made better off. As we shall see, these beneficiaries are not necessarily those at the low end of the wage scale.

As a first approach to the question, we should ask who promotes this legislation? One important group consists of labor unions, or, more precisely, union leaders. But you might ask why labor unions would want a minimum wage. No union member earns a wage nearly as low as the legal minimum. The vast majority earn substantially more. So why should they support a minimum wage? Recall from our earlier discussion that unskilled workers can be used as substitutes for skilled workers and skilled workers, as substitutes for unskilled.

Let us return to our patio building example. Remember, that you could build a patio using a skilled carpenter eight hours at $20 an hour. Or you could hire an unskilled laborer to build it in 24 hours at $5 an hour. Obviously, the lower cost method is to hire the unskilled laborer and pay $120 rather than hire the carpenter and pay $160.

If the carpenter could have imposed a minimum wage of $10 an hour for any laborer regardless of skill, he could still ask $20; but now you would hire him because he would be cheaper than using unskilled labor. The imposed minimum wage would induce substitution away from unskilled to skilled labor.

The same thing occurs in the case of union labor, which is basically skilled. Requiring firms to pay a minimum wage for all jobs increases the demand for skilled labor, because a good substitute, unskilled workers, costs more. Obviously, this increase in the demand for skilled labor raises the wage rates that unions can ask without reducing employment. Put simply, by increasing the wage required to be paid to unskilled labor, government increases the wages of skilled labor, union and otherwise. So is it any surprise that the unions are such strong proponents of a Federal minimum? They are major beneficiaries.

We might note that it was the Northeastern textile workers' unions that originally pushed for minimum wage legislation. At that time, the 1930's, Northern textile workers were making more than the proposed minimum wage. But, the Northern textile mills were being undersold by non-union Southern mills, which were paying lower wages. Consequently, many Northern mills were being driven out of business by the competition. As Northern mills shut down, or moved to the South,

union textile workers were losing their jobs. Neither the Northern managers nor the unions liked the situation.

What is an obvious way to force Southern mills to pay higher wages and hence charge higher prices? Obviously, lobby for a minimum wage above the going wage rates in the South. And that is exactly what happened.

Both the Northern firms and the unions pushed hard for minimum wage legislation. And they were successful. In 1938 a minimum wage law was enacted, to cover primarily manufacturing. While the wage was relatively low, it was higher than the wages being paid by many Southern manufacturing firms. Thus, the Southern firms were not able to compete with Northern firms as well as they did before. Many Northern jobs were saved — at the expense of some Southern jobs.

And the same thing is going on right now. What is the best way to keep low skilled workers from competing with higher paid, more skilled labor? Lobby for higher minimum wages and more extensive coverage. So we can see that higher paid workers are made better off by forcing firms to pay a minimum wage, even though some people may be unemployed because of this enforced minimum. Without the minimum wage, some workers would find their wages reduced, or at least their wages would not rise so rapidly.

We see further evidence of who benefits from minimum wages and therefore who supports them, when we note who protests when someone proposes lowering or even eliminating the requirement of a minimum wage for certain disadvantaged groups — the most frequently mentioned are teenagers. Many people have suggested that firms should be permitted to pay wages lower than the minimum wage to teenagers, since teenagers represent such a large proportion of the unemployed.

In general, unions resist even this small relaxation of the law. Their argument, and it is to some extent well taken, is that if teenagers are permitted to work for less than the minimum wage, some workers who support families will lose their jobs. Certainly, some skilled workers may well lose their jobs, but it is more likely that their wages would not rise as rapidly as would otherwise be the case. Thus it is clear that union leaders understand the true impact of minimum wage laws.

In January 1983 President Reagan proposed a "sub-minimum wage" that would permit teenagers — and only teenagers — to work for $2.50 an hour, 85 cents below the minimum. And this relaxation of the minimum wage was to be in effect only during the summer months. This restriction was supposed to limit opposition. At the time, unemployment for teenagers, 16 through 19 years old, stood at 24.5 percent. This high a rate had not been reached since the Great Depression of the 1930's. It was estimated that this reduction in the minimum wage would

result in an additional 400,000 to 600,000 teenagers being employed in the summer.

This in itself doesn't seem to be such a drastic move. Nonetheless, labor leaders generally opposed it, pointing out that teenagers working for lower wages would compete with older workers — union workers. The president of the United Steelworkers was quoted as saying that any sub-minimum wage for teenagers would "encourage the replacement of adult job holders, who have the responsibility of supporting themselves and usually families as well, with substantially lower-paid youngsters."

This has usually been the response of unions leaders to suggestions of reducing or eliminating the minimum wage for certain groups of workers. And they are correct. It is certainly possible that union workers could be adversely affected, possibly not because they would lose their jobs but because their wages would not rise as fast as would be the case otherwise.

While we have emphasized union workers in our analysis, we do not mean to imply that they are the only workers who can benefit from the reduced competition for jobs under minimum wage legislation. Certainly unorganized nonunion labor can be helped also.

For example, lower skilled whites are protected to some extent from low skilled black workers who would be willing to work for lower wages. The same thing holds true for male workers, workers who are protected from the competition of lower paid females, or perhaps from workers who are physically handicapped. In fact, any workers who receive higher wages than would be the case if they were not sheltered from low wage competition are better off with the minimum wage law than without it.

We have seen then that some workers are made better off by government imposing minimum wage laws. These people are those who are able to find and keep jobs at wage rates higher than would be the case otherwise. On the other hand, those who cannot find work at wages at or above the minimum are worse off with minimum wage legislation.

But what can we say about proposals to lower or even reduce the minimum wage for specific groups where the unemployment rate is alarmingly high — most frequently, teenagers or teenagers in summer jobs? Maybe we should carry such proposals to their logical extension. If the minimum wage should be eliminated for teenagers, or for teenagers in the summer, because many teenagers cannot find jobs, what about other lower skilled workers who cannot find jobs because of the minimum wage? Should these marginal workers be excluded from jobs because of low productivity relative to the minimum wage rate? If not, why not reduce or even eliminate the minimum wage rate for them? Or if we would eliminate the minimum for these special cases, why not

eliminate it for all? Certainly, that's the logical conclusion. But as we have seen, this reduces the wage rate of some more productive workers.

So if unions strongly resist reductions in the minimum in the case of teenagers, even for summer jobs only, wouldn't they resist lowering or eliminating the minimum for all workers, regardless of age? Of course they would. And it is in their self interest to do so.

Thus this question, as is the case for practically all problems of economic policy, becomes a question of who benefits and who loses. In this case, those who benefit have the political clout to resist change. Those who lose have little if any political power to bring changes about. And, as is the case for most problems of economic policy, many simply do not see or understand the implications.

Conclusions

Whether or not we can draw any policy implications from our discussion or say whether such legislation is good or bad, at least we are in a position to determine who benefits and who loses because of a Federally imposed minimum wage.

First, those who benefit. As we have seen, more productive workers, sheltered from low wage competition from less productive workers, receive somewhat higher wages than would be the case without a minimum wage. Certainly, the unions make a good case that if some workers are permitted to work at wages below minimum, some higher paid workers, organized or not, could lose their jos and be forced to work at jobs with a lower pay scale. The extent to which this would occur is very difficult to estimate.

Who loses? As we have discussed, a legislated minimum wage prevents workers who are less productive, or less experienced, or possibly less desirable in the minds of employers from competing for jobs by taking lower wages while they get experience or prove themselves to employers. As we would expect, teenagers, particularly minority teenagers, are most severely affected. When these teenagers are prevented from taking jobs where they can receive work experience, many are relegated to the unemployment roles for the rest of their lives. The same holds true for minority workers. Again, the extent of these adverse consequences is very difficult to estimate.

So we have seen who benefits and who loses. We hope that you now see that the desirability or social benefit of a Federally legislated minimum wage is not so obvious as appears at first. Many of those the minimum wage is supposed to benefit — low skilled workers — are the most disadvantaged by such laws. Government can legislate that firms must pay above some arbitrary level to workers. It cannot legislate that these workers must be hired.

Minimum wage laws, as is the case for much social legislation, have underlying implications that go far beyond the original intent of these laws. All too frequently, laws ostensibly designed to benefit one segment of society actually hurt many who were supposed to be helped by such legislation.

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